



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Number: **201230024**
Release Date: 7/27/2012

Date: May 2, 2012

Contact Person:

Identification Number:

Contact Number:

Employer Identification Number:

Form Required To Be Filed:

Tax Years:

UIL: 501.32-00; 501.32-01; 501.33-00

Dear :

This is our final determination that you do not qualify for exemption from Federal income tax as an organization described in Internal Revenue Code section 501(c)(3). Recently, we sent you a letter in response to your application that proposed an adverse determination. The letter explained the facts, law and rationale, and gave you 30 days to file a protest. Since we did not receive a protest within the requisite 30 days, the proposed adverse determination is now final.

Since you do not qualify for exemption as an organization described in Code section 501(c)(3), donors may not deduct contributions to you under Code section 170. You must file Federal income tax returns on the form and for the years listed above within 30 days of this letter, unless you request an extension of time to file.

We will make this letter and our proposed adverse determination letter available for public inspection under Code section 6110, after deleting certain identifying information. Please read the enclosed Notice 437, *Notice of Intention to Disclose*, and review the two attached letters that show our proposed deletions. If you disagree with our proposed deletions, you should follow the instructions in Notice 437. If you agree with our deletions, you do not need to take any further action.

In accordance with Code section 6104(c), we will notify the appropriate State officials of our determination by sending them a copy of this final letter and the proposed adverse letter. You should contact your State officials if you have any questions about how this determination may affect your State responsibilities and requirements.

Letter 4038(CG) (11-2005)
Catalog Number 47632S

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter. If you have any questions about your Federal income tax status and responsibilities, please contact IRS Customer Service at 1-800-829-1040 or the IRS Customer Service number for businesses, 1-800-829-4933. The IRS Customer Service number for people with hearing impairments is 1-800-829-4059.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure
Notice 437
Redacted Proposed Adverse Determination Letter
Redacted Final Adverse Determination Letter



**DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224**

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: March 15, 2012

Contact Person:

Identification Number:

Contact Number:

FAX Number:

Employer Identification Number:

LEGEND:

N = For-Profit Enterprise
O = State
U = Incorporation Date
P = Geographic Area
Q = Entertainment and Meeting Venue
R = Entertainment and Meeting Venue
w = \$Dollar Amount

UIL:

501.32-00
501.32-01
501.33-00

Dear :

We have considered your application for recognition of exemption from federal income tax under Internal Revenue Code section 501(a). Based on the information provided, we have concluded that you do not qualify for exemption under Code section 501(c)(3). The basis for our conclusion is set forth below.

Issues

- Have you failed to demonstrate that you meet the operational test by operating exclusively for an exempt purpose under section 501(c)(3) of the Code? Yes for the reasons stated below.
- Do you benefit private interests, which could preclude exemption under section 501(c)(3) of the Code? Yes for the reasons stated below.
- Do you qualify for exemption under section 501(c)(3) of the Code? No, for the reasons stated below.

Letter 4036 (CG) (11-2005)
Catalog Number 47630W

Facts

You were formed on U in O as a public benefit corporation whose originally stated purpose or "general nature of the business" is to raise and distribute funds for the benefit of various youth organizations in the metro area of P. You amended your Articles of Incorporation to provide that you are organized exclusively for charitable, religious, educational and scientific purposes under section 501(c)(3) of the Code. Your management is vested in your three person board of directors who also serve as officers, President, Treasurer and Secretary, respectively. Your Bylaws state that the initial board would consist of one board member for one year at which time a complete board would be elected.

You stated that your fundraising activities are two-fold. You provide opportunities for individuals to earn money for their personal use by selling concessions at events held at Q and R. Second, any funds in excess of expenses that you have at the end of the fiscal year "will be awarded to a group to utilize the funds to provide opportunities to those who may not have the financial means to otherwise participate in educational or extra-curricular activities, religious organizations or activities, national amateur sports organizations or activities, and charitable organizations or activities". Q and R host various events attracting large numbers of attendees. A for-profit entity, N, supervises the concession sales, which are your primary fundraising activities, and provides everything required to operate the concession facility or booth (such as uniforms, food, training, and equipment).

Your activities consist of staffing the booth to prepare the food, sell the products and clean the booth for N. In return for the time spent, N contributes 9% to 11% of net profits from each event to you. This percentage can be enhanced by 2%, if you cover the cost of workers compensation insurance. You note that other volunteer not-for-profit groups sell concessions for N at Q and R. For volunteering time to run concessions, not-for-profit organizations receive funds to distribute for non-profit organizations and activities.

You will hire a group of people to work part time as their personal schedules allow and you will pay them \$w per hour for their time. You estimate that on an annual basis you will work more than 100 events, sales would be more than \$600,000 and you will receive approximately \$70,000 in net proceeds. Funds remaining after paying workers would be retained for distribution to various charitable entities at the end of the year.

You state that you want to become tax exempt to provide charitable assistance for children and others in the community directly, on your own, in addition to supporting other charitable organizations. You will do this through the wages you earn from the for-profit entity and, in addition, you will provide contributions to the community from your net proceeds at the end of the year.

Your breakdown of income and expenses indicates that over 90% of your income would be spent paying salaries and other administrative expenses such as insurance. Any amounts remaining would be donated to charities as determined by the board.

In later correspondence, you have indicated that staffing concession stands at various events will be your primary source of income and that any additional volunteer-staffed activities such as raffles, candy sales, car washes and/or operating a fireworks sales stand will only be conducted if there is enough money after working the events at Q and R. You estimate that a majority (60%) of your time will be spent staffing events at Q and R.

Law

Section 501(c)(3) of the Code provides, in part, for the exemption from federal income tax of: "Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment)..."

Income Tax Regulation § 1.501(c)(3)-1(a)(1) states:

"In order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt."

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities that accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations defines charitable as relief of the poor and distressed or of the underprivileged; advancement of education & science; advancement of religion; erection or maintenance of public buildings, monuments or works; lessening the burdens of government; promotion of social welfare by organizations designed to accomplish any of the above purposes; to lessen neighborhood tensions; to eliminate prejudice and discrimination; to defend human and civil rights secured by law; and to combat community deterioration and juvenile delinquency

Section 1.501(c)(3)-1(e) provides that an organization may meet the requirements of section 501(c)(3) if it operates a trade or business that is in furtherance of its exempt purposes but not if it is operated for the primary purpose of carrying on an unrelated trade of business as defined in section 513 of the Code.

Revenue Ruling 61-170, 1961-1 C.B. 112, held that an association composed of professional private duty nurses and practical nurses which supported and operated a nurses' registry primarily to afford greater employment opportunities for its members was not entitled to exemption under section 501(c)(3) of the Code. Although the public received some benefit from the organization's activities, the primary benefit of these activities was to the organization's members.

Revenue Ruling 71-529, C.B. 1971-2, 234, includes a situation where an organization controlled by a group of exempt organizations and providing investment management services for a charge substantially less than cost solely to that group qualifies for exemption from Federal income tax under section 501(c)(3) of the Code. In this case, the organization obtained contributions to cover all or part of the cost of the management services it provided and also used the contributions to provide supplemental income or capital to be used exclusively for the charitable, educational, or scientific purposes of the organizations it served. In addition, the fees paid by the member organization represented less than fifteen percent of the total costs of operation.

Revenue Ruling 72-369, 1972-2 C.B. 245, states that an organization formed to provide managerial and consulting services at cost to unrelated exempt organizations does not qualify for exemption. Providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit. The fact that the services in this case are provided at cost and solely for exempt organizations is not sufficient to characterize this activity as charitable within the meaning of section 501(c)(3) of the Code. Furnishing the services at cost lacks the donative element necessary to establish this activity as charitable.

Rev. Rul. 73-127, 1973-1 C.B. 221, states a nonprofit organization that operates a low cost retail grocery store and allocates a small portion of its earnings to provide on-the-job training of hard-core unemployed of a poverty area does not qualify for exemption.

In Better Business Bureau of Washington D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In Old Dominion Box Co. v. United States, 477 F2d 344 (4th Cir. 1973) cert. Denied 413 U.S. 910 (1973) the court held that operating for the benefit of private parties constitutes a substantial non-exempt purpose.

Harding Hospital, Inc. v. United States, 505 F2d 1068 (1974), holds that an organization seeking a ruling as to recognition of its tax exempt status has the burden of proving that it satisfies the requirements of the particular exemption statute. Whether an organization has satisfied the operational test is a question of fact.

In B.S.W. Group, Inc v. Commissioner, 70 T.C. 352 (1978), the Tax Court held that an organization did not qualify for exemption under section 501(c)(3) of the Code because it was primarily engaged in an activity that was characteristic of a trade or business and ordinarily

carried on by for-profit commercial business. The Tax Court stated that the corporation's primary purpose was not charitable, educational or scientific, but rather commercial in nature.

In est of Hawaii v. Commissioner, 71 T.C. at 1080-81 the court determined that a critical determination is not whether transactions with a for-profit organization are reasonable or excessive, but instead whether the entire enterprise is carried on in such a manner that the for-profit organization benefits substantially from the operation of the exempt organization.

In Church by Mail, Inc. v. Commissioner, 765 F.2d 1387, 1390 (9th Cir. 1985) the court upheld that an organization operated for the substantial non-exempt purpose of providing a market for a for-profit corporation was not exempt under section 501(c)(3) of the Code.

In this case, a non-profit organization was formed to promote religion through the distribution of printed religious messages. The non-profit organization was related to a for-profit corporation that provided the printing and mailing services for the non-profit organization. The for-profit corporation also provided similar services to others as part of its normal commercial operations.

The court determined that the non-profit organization was operated for the non-exempt purpose of providing a market for the for-profit corporation's services and that this non-exempt purpose would preclude exemption under section 501(c)(3) of the Code.

In Airlie Foundation v. Internal Revenue Service, 283 F Supp. 2d 58 (D.D.C. 2003), the District Court found that the organization was formed principally to organize, host, conduct and sponsor educational and other charitable functions at its facilities. The organization's patrons were not limited to tax-exempt entities, but included patrons of a private and corporate nature. The organization paid significant advertising and promotional expenses and derived substantial income from the weddings and special events held at its conference center. Because plaintiff operates its conference center in a manner consistent with that of a commercial business, it does not meet the requirements of Code Section 501(c)(3) and is therefore not entitled to tax-exempt status. Though plaintiff carries out a number of charitable and educational activities, these are incidental to its primary activity of operating a conference center.

Application of Law

You do not meet the operational test since you are not operated for exempt purposes consistent with section 501(c)(3) of the Code. You have presented your charitable purpose as the raising and distribution of funds for the benefit of various youth organizations in the metro area of P. However, you are comparable to a professional fundraiser that employs individuals to raise funds. Your activities consist of hiring individuals and paying the prevailing wage to work in concession booths for events held at Q and R. You have stated that this employment would provide for the personal use of individuals employed through the wages earned and provide to the community through the donation of your annual net proceeds at the end of the year. You are in competition with other for-profit employment establishments. These facts demonstrate a commercial and substantially non-exempt purpose inconsistent with Section 501(c)(3) of the Code. Section 1.503(c)(3)-1(d)(2), which defines charitable as relief of the poor and distressed. The activities you are conducting are not relieving the poor and distressed.

Because you are providing an employment service to N for events conducted at Q and R, you are operating similar to a commercial employment business. Section 1.501(c)(3)-1(e) states that an organization may operate a trade or business if it is in furtherance of its exempt purpose and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business. Your primary purpose is to provide employees to operate concession stands for N to conduct its regular business operations at Q and R. Therefore, you are not operating exclusively for charitable purposes.

Although, you do intend to annually donate funds raised in excess of expenses to religious or charitable organizations, you also serve substantial commercial purposes. Because the employment service is operating for purposes inconsistent with exclusive 501(c)(3) activities, you do not meet the specifications of this regulation. As a result, by sections 1.501(c)(3)-1(a)(1) and 1.501(c)(3)-1(c)(1) of the regulations, you do not qualify because you are not organized and operated exclusively for one or more exempt purposes, and, in addition, a substantial part of your activities consists of operating a trade or business.

Your operation of an employment service paying a prevailing wage is similar to a commercial business. Your operations are similar to those described in B.S.W. Group and Airlie Foundation, as your services are competing with other non-exempt, commercial, for-profit enterprises. As in B.S.W. Group you are engaged in an activity that is characteristic of a trade or business ordinarily carried out by a for-profit commercial business. Furthermore, you are similar to the organization in the Airlie Foundation decision. Although you intend to annually donate funds in excess of expenses, you operate in a manner consistent with that of a commercial business. Donating net proceeds to charity does not differentiate you from commercial operation or establish an exclusive charitable purpose.

You are also similar to organizations described in the court cases Better Business Bureau and est of Hawaii. In each of these cases, the particular organization was found to operate in a substantially non-exempt manner due to the nature of their activities. Your operations are similar to the operations of the organizations affected by these rulings because your primary purpose is to provide employment services for N and pay a prevailing wage. Furthermore, the fact that N will contribute to you an additional 2% of net profits from each event, if you cover the cost of workers compensation insurance, exemplifies another way in which your operation benefits N. As in est of Hawaii, your enterprise is carried on in such a manner that the for-profit organization benefits substantially from your operation.

In Harding Hospital, the court determined that it was the organization's burden to show that it was operated exclusively for exempt purposes. You have not demonstrated that you are operating exclusively for exempt purposes and not for the private interests of the employed individuals or N.

The organizations described in Rev. Rul. 72-369 and 73-127 were found to be operating similar to commercial business and for a non-exempt purpose. You are operating in a manner similar to these organizations. You are not volunteering time to run concessions, because you are paying prevailing wages to individuals engaged in commercial activity, as well as providing an employment service for N.

Regulations section 1.501(c)(3) -1(d)(1)(ii) states that you must not operate for the interests of private individuals. You were formed for the purpose of providing employment for individuals, who benefit from your operation of concession facilities for the benefit of a for-profit enterprise, N. Therefore, you do not meet the regulation's requirements.

You are not operated for exempt purposes consistent with Section 501(c)(3) of the Code. In Rev. Rul. 61-170 and Rev. Rul. 71-529, because the organizations were providing services for the members of the affected organizations (which constitute a private benefit) the organizations did not qualify for tax exemption. By providing concession stand staff for N at the various events held at Q and R, you are providing a benefit to N, and the individuals you employ are personally benefiting from the wages received.

You have also not demonstrated that you are operating exclusively for exempt purposes and not for private benefit. You are similar to the organizations described in Old Dominion Box Company in that your operations for the benefit of private parties constitute a substantial non-exempt purpose. Likewise, as in Church by Mail, in your pursuit of a fundraising goal, you were formed to provide employment for individuals in support of the for-profit enterprise of N. This is not an exempt purpose under section 501(c)(3). In these cases, courts determined that organizations were operating for the interests of individuals and related for-profit businesses which precluded them from exemption.

Applicant's Position

You provided a list of new activities that you will conduct which included several fundraising activities that will be conducted by volunteers. You indicated that you will need to be paid by N in order to conduct the new activities.

Service Response to Applicant's Position

Your statement indicated that sixty percent of the time you would be providing staff to N for activities conducted in Q and R, and only if you had funds left over, would the other activities be conducted. You also stated that funds received from N would determine how many and how often you could conduct the other activities and events.

Therefore, you will continue to operate in a commercial manner since the new activities would be conducted only if N provided enough funds to conduct these other activities. Your primary purpose and operation is providing an employment service for N.

Conclusion

You do not meet the requirements under IRC section 501(c)(3) because your operation of employment services for individuals whom you employ is consistent with running a trade or business and not as described in the Code. You operate for non-exempt commercial purposes. In addition, you have failed to establish that your activities further an exclusively tax-exempt purpose within the meaning of section 501(c)(3) of the Code. Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3).

You have not demonstrated that you are operating exclusively for a charitable or educational purpose. You are operating for the private benefit of N and the individuals employed by the organization.

Based upon the above facts and law, you do not qualify for exemption under section 501(c)(3).

You have the right to file a protest if you believe this determination is incorrect. To protest, you must submit a statement of your views and fully explain your reasoning. You must submit the statement, signed by one of your officers, within 30 days from the date of this letter. We will consider your statement and decide if the information affects our determination. If your statement does not provide a basis to reconsider our determination, we will forward your case to our Appeals Office. You can find more information about the role of the Appeals Office in Publication 892, *Exempt Organization Appeal Procedures for Unagreed Issues*.

Types of information that should be included in your appeal can be found on page 2 of Publication 892, under the heading "Regional Office Appeal". The statement of facts (item 4) must be accompanied by the following declaration:

"Under penalties of perjury, I declare that I have examined the statement of facts presented in this appeal and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

The declaration must be signed by an officer or trustee of the organization who has personal knowledge of the facts.

Your appeal will be considered incomplete without this statement.

If an organization's representative submits the appeal, a substitute declaration must be included stating that the representative prepared the appeal and accompanying documents; and whether the representative knows personally that the statements of facts contained in the appeal and accompanying documents are true and correct.

An attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service may represent you during the appeal process. If you want representation during the appeal process, you must file a proper power of attorney, Form 2848, *Power of Attorney and Declaration of Representative*, if you have not already done so. You can find more information about representation in Publication 947, *Practice Before the IRS and Power of Attorney*. All forms and publications mentioned in this letter can be found at www.irs.gov, Forms and Publications.

If you do not file a protest within 30 days, you will not be able to file a suit for declaratory judgment in court because the Internal Revenue Service (IRS) will consider the failure to appeal as a failure to exhaust available administrative remedies. Code section 7428(b)(2) provides, in part, that a declaratory judgment or decree shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted all of the administrative remedies available to it within the IRS.

If you do not intend to protest this determination, you do not need to take any further action. If we do not hear from you within 30 days, we will issue a final adverse determination letter. That letter will provide information about filing tax returns and other matters.

Please send your protest statement, Form 2848, and any supporting documents to the applicable address:

Mail to:

Internal Revenue Service
EO Determinations Quality Assurance
Room 7-008
P.O. Box 2508
Cincinnati, OH 45201

Deliver to:

Internal Revenue Service
EO Determinations Quality Assurance
550 Main Street, Room 7-008
Cincinnati, OH 45202

You may fax your statement using the fax number shown in the heading of this letter. If you fax your statement, please call the person identified in the heading of this letter to confirm that he or she received your fax.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Lois G. Lerner
Director, Exempt Organizations

Enclosure, Publication 892